

# Adam smith 1710 essay



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## Adam Smith

Adam Smith, a brilliant eighteenth-century Scottish political economist, had the advantage of judging the significance of colonies by a rigorous examination based on the colonial experience of 300 years. His overview has a built-in bias: he strongly disapproved of excessive regulation of colonial trade by parent countries. But his analysis is rich with insight and remarkably dispassionate in its argument. Adam Smith recognized that the discovery of the New World not only brought wealth and prosperity to the Old World, but that it also marked a divide in the history of mankind. The passage that follows is the work of this economic theorist who discusses problems in a language readily understandable by everyone.

Adam Smith had retired from a professorship at Glasgow University and was living in France in 1764-5 when he began his great work, *The Wealth of Nations*. The book was being written all during the years of strife between Britain and her colonies, but it was not published until 1776. In the passages which follow, Smith points to the impossibility of monopolizing the benefits of colonies, and pessimistically calculates the cost of empire, but the book appeared too late to have any effect upon British policy. Because the Declaration of Independence and *The Wealth of Nations*, the political and economic relations of empire and mercantilism, appeared in the same year, historians have often designated 1776 as one of the turning points in modern history. The text *On the cost of Empire*, the eloquent exhortation to the rulers of Britain to awaken from their grandiose dreams of empire, is the closing passage of Smith's book.

Adam Smith was a Scottish political economist and philosopher. He has become famous by his influential book *The Wealth of Nations* (1776). Smith was the son of the comptroller of the customs at Kirkcaldy, Fife, Scotland. The exact date of his birth is unknown. However, he was baptized at Kirkcaldy on June 5, 1723, his father having died some six months previously.

At the age of about fifteen, Smith proceeded to Glasgow university, studying moral philosophy under “the never-to-be-forgotten” Francis Hutcheson (as Smith called him). In 1740 he entered Balliol college, Oxford, but as William Robert Scott has said, “the Oxford of his time gave little if any help towards what was to be his lifework,” and he relinquished his exhibition in 1746. In 1748 he began delivering public lectures in Edinburgh under the patronage of Lord Kames. Some of these dealt with rhetoric and belles-lettres, but later he took up the subject of “the progress of opulence,” and it was then, in his middle or late 20s, that he first expounded the economic philosophy of “the obvious and simple system of natural liberty” which he was later to proclaim to the world in his *Inquiry into the Nature and Causes of the Wealth of Nations*. About 1750 he met David Hume, who became one of the closest of his many friends.

In 1751 Smith was appointed professor of logic at Glasgow university, transferring in 1752 to the chair of moral philosophy. His lectures covered the field of ethics, rhetoric, jurisprudence and political economy, or “police and revenue.” In 1759 he published his *Theory of Moral Sentiments*, embodying some of his Glasgow lectures. This work, which established Smith’s reputation in his own day, is concerned with the explanation of moral

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approval and disapproval. His capacity for fluent, persuasive, if rather rhetorical argument is much in evidence. He bases his explanation, not as the third Lord Shaftesbury and Hutcheson had done, on a special "moral sense," nor, like Hume, to any decisive extent on utility, but on sympathy. There has been considerable controversy as how far there is contradiction or contrast between Smith's emphasis in the *Moral Sentiments* on sympathy as a fundamental human motive, and, on the other hand, the key role of self-interest in the *The Wealth of Nations*. In the former he seems to put more emphasis on the general harmony of human motives and activities under a beneficent Providence, while in the latter, in spite of the general theme of "the invisible hand" promoting the harmony of interests, Smith finds many more occasions for pointing out cases of conflict and of the narrow selfishness of human motives.

Smith now began to give more attention to jurisprudence and political economy in his lecture and less to his theories of morals. An impression can be obtained as to the development of his ideas on political economy from the notes of his lectures taken down by a student in about 1763 which were later edited by E. Cannan (*Lectures on Justice, Police, Revenue and Arms*, 1896), and from what Scott, its discoverer and publisher, describes as "An Early Draft of Part of *The Wealth of Nations*, which he dates about 1763.

At the end of 1763 Smith obtained a lucrative post as tutor to the young duke of Buccleuch and resigned his professorship. From 1764-66 he traveled with his pupil, mostly in France, where he came to know such intellectual leaders as Turgot, D'Alembert, Andr Morellet, Helv tius and, in particular, Francois Quesnay, the head of the Physiocratic school whose work

he much respected. On returning home to Kirkcaldy he devoted much of the next ten years to his magnum opus, which appeared in 1776. In 1778 he was appointed to a comfortable post as commissioner of customs in Scotland and went to live with his mother in Edinburgh. He died there on July 17, 1790, after a painful illness. He had apparently devoted a considerable part of his income to numerous secret acts of charity.

Shortly before his death Smith had nearly all his manuscripts destroyed. In his last years he seems to have been planning two major treatises, one on the theory and history of law and one on the sciences and arts. The posthumously published *Essays on Philosophical Subjects* (1795) probably contain parts of what would have been the latter treatise.

*The Wealth of Nations* has become so influential since it did so much to create the subject of political economy and develop it into an autonomous systematic discipline. In the western world, it is the most influential book on the subject ever published. When the book, which has become a classic manifesto against mercantalism, appeared in 1776, there was a strong sentiment for free trade in both Britain and America. This new feeling had been born out of the economic hardships and poverty caused by the war. However, at the time of publication, not everybody was convinced of the advantages of free trade right away: the British public and Parliament still clung to mercantilism for many years to come (Tindall and Shi). However, controversial views have been expressed as to the extent of Smith's originality in *The Wealth of Nations*. Smith has been blamed for relying too much on the ideas of great thinkers such as David Hume and Montesquieu.

Nevertheless, *The Wealth of Nations* was the first and remains the most important book on the subject of political economy until this present day.

It has never, I think, been the good fortune of any founder of a scientific system to think out to the very end even the more important ideas that constitute his system. The strength and lifetime of no single man are sufficient for that. It is enough if some few of the ideas which have to play the chief part in the system are put on a perfectly safe foundation, and analysed in all their ramifications and complexities. It is a great deal if, over and above that, an equal carefulness falls to the lot of a few other favoured members of the system. But in all cases the most ambitious spirit must be content to build up a great deal that is insecure, and to fit into his system, on cursory examination, ideas which it was not permitted him to work out.

We must keep these considerations before us if we would rightly appreciate Adam Smith's attitude towards our problem.

Adam Smith has not overlooked the problem of interest; neither has he worked it out. He deals with it as a great thinker

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may deal with an important subject which he often comes across, but has not time or opportunity to go very deeply into. He has adopted a certain proximate but still vague explanation. The more indefinite this explanation is, the less does it bind him to strict conclusions; and a many-sided mind like Adam Smith's, seeing all the many different ways in which the problem can be put, but lacking the control which the possession of a distinct theory gives, could scarcely fail to fall into all sorts of wavering and contradictory expressions. Thus we have the peculiar phenomenon that, while Adam Smith has not laid down any distinct theory of interest, the germs of almost all the later and conflicting theories are to be found, with more or less distinctness, in his scattered observations. We find the same phenomenon in Adam Smith as regards many other questions. The line of thought which seems to commend itself principally to him as explaining natural interest occurs in very similar language in the sixth and eighth chapters of book i of the Wealth

of Nations. It amounts to this, that there must be a profit from capital, because otherwise the capitalist would have no interest in spending his capital in the productive employment of labourers.(1\*)

General expressions like these have of course no claim to stand for a complete theory.(2\*) There is no reasoned attempt in them to show what we are to represent as the actual connecting links between the psychological motive of the capitalist's self-interest and the final fixing of market prices which leave a difference between costs and proceeds that we call interest. But yet, if we take those expressions in connection with a later passage,(3\*) where Smith sharply opposes the "future profit" that rewards the resolution of the capitalist to the "present enjoyment" of immediate consumption, we may recognise the first germs of that theory which Senior worked out later on under the name of the Abstinence theory.

In the same way as Adam Smith asserts the necessity of



interest, and leaves it without going any deeper in the way of proof, so does he avoid making any systematic investigation of the important question of the source of undertaker's profit. He contents himself with making a few passing observations on the subject. Indeed in different places he gives two contradictory accounts of this profit. According to one account, the profit of capital arises from the circumstance, that, to meet the capitalist's claim to profit, buyers have to submit to pay something more for their goods than the value which these goods would get from the labour expended on them. according to this explanation, the source of interest is an increased value given to the product over that value which labour creates; but no explanation of this increase in value is given. According to the second account, interest is a deduction which the capitalist makes in his own favour from the return to labour, so that the workers do not receive the full value created by them, but are obliged to share it with the capitalist. According to this

account, profit is a part of the value created by labour and kept back by capital.

Both accounts are to be found in a great number of passages; and these passages, oddly enough, sometimes stand quite close to each other, as, e. g. in the sixth chapter of the first book.

Adam Smith has been speaking in that chapter of a past time, — of course a mythical time, — when the land was not yet appropriated, and when an accumulation of capital had not yet begun, and has made the remark that, at that time, the quantity of labour required for the production of goods would be the sole determinant of their price. He continues: “ As soon as stock has accumulated in the hands of particular persons, some of them will naturally employ it in setting to work industrious people, whom they will supply with materials and subsistence, in order to make a profit by the sale of their work, or by what their labour adds to the value of the materials. In exchanging the complete manufacture either for money, for labour, or for other goods,

over and above what may be sufficient to pay the price of the materials and the wages of the workmen, something must be given for the profits of the undertaker of the work, who hazards his stock in this adventure.”

This sentence, when taken with the opposite remark of the previous paragraph (that, in primitive conditions, labour is the sole determinant of price), very clearly expresses the opinion that the capitalist’s claim of interest causes a rise in the price of the product, and is met from this raised price. But Adam Smith immediately goes on to say: “ The value which the workman adds to the material, therefore, resolves itself in this case into two parts, of which the one pays the wages, the other the profits of the employer upon the whole stock of materials and wages which he advanced.” Here again the price of the product is looked upon as exclusively determined by the quantity of labour expended, and the claim of interest is said to be met by a part of the return which the worker has produced.

We meet the same contradiction, but even more strikingly, a page farther on.

“ In this state of things,” says Adam Smith, “ the whole produce of labour does not always belong to the labourer. He must in most cases share it with the owner of the stock which employs him.” This is an evident paraphrase of the second account. But immediately after that come the words: “ Neither is the quantity of labour commonly employed in acquiring or producing any commodity, the only circumstance which can regulate the quantity which it ought commonly to purchase, command, or exchange for. An additional quantity, it is evident, must be due for the profits of the stock which advanced the wages and furnished the materials of that labour.” He could scarcely have said more plainly that the effect of a claim of interest is to raise prices without curtailing the wages of labour.

Later on he says alternately: “ As in a civilised community there are but few commodities of which the exchangeable value

arises from labour only, rent and profit contributing largely to that of the far greater part of them, so the annual produce of its labour will always be sufficient to purchase or command a much greater quantity of labour than was employed in raising, preparing, and bringing that produce to market” (first account, chap. vi.) “ The produce of almost all other labour is liable to the like deduction of profit. In all arts and manufactures the greater part of the workmen stand in need of a master to advance them the materials of their work, and their wages and maintenance till it be completed. He shares in the produce of their labour, or in the value which it adds to the materials upon which it is bestowed; and in this consists his profit” (second account, chap. viii.)

“ High or low wages and profit are the causes of high or low price; high or low rent is the effect of it” (first account, chap. xi.)

Contradictions like these on the part of such an eminent

thinker admit, I think, of only one explanation; — that Adam Smith had not thoroughly thought out the interest problem; and — as is usual with those who have only imperfectly mastered a subject — was not very particular in his choice of expressions, but allowed himself to be swayed very much by the changing impressions which the subject may have made on him from time to time.

Adam Smith, then, has no perfected theory of interest.(4\*)

But the suggestions he threw out were all destined to fall on fruitful soil. His casual remark on the necessity of interest was developed later into the Abstinence theory. In the same way the two accounts he gave of the source of interest were taken up by his followers, logically carried out, and raised into principles of independent theories. With the first account — that interest is paid out of an additional value which the employment of capital calls into existence — are connected the later Productivity theories. With the second account — that interest

is paid out of the return to labour — are connected the

Socialist theories of interest. Thus the most important of later

theories trace their pedigree back to Adam Smith.

The position taken by Adam Smith towards the question may be

called that of a complete neutrality. He is neutral in his

theoretical exposition, for he takes the germs of distinct

theories and puts them beside each other, without giving any one

of them a distinct prominence over the others. And he is neutral

in his practical judgment, for he maintains the same reserve, or

rather the same contradictory hesitancy, both in praise and blame

of interest. Sometimes he commends the capitalists as benefactors

of the human race, and as authors of enduring blessing;(5\*)

sometimes he represents them as a class who live on deductions

from the produce of other people's labour, and compares them

significantly with people " who love to reap where they never

sowed."(6\*)

In Adam Smith's time the relations of theory and practice

still permitted such a neutrality, but it was not long allowed to his followers. Changed circumstances compelled them to show their colours on the interest question, and the compulsion was certainly not to the disadvantage of the science.

The special requirements of economic theory could not any longer put up with uncertain makeshifts. Adam Smith had spent his life in laying down the foundations of his system. His followers, finding the foundations laid, had now time to take up those questions that had been passed over. The development now reached by the related problems of land-rent and wages gave a strong inducement to pursue the interest problem. There was a very complete theory of land-rent; there was a theory of wages scarcely less complete. Nothing was more natural than that systematic thinkers should now begin to ask in earnest about the third great branch of income the whence and wherefore of the income that comes from the possession of capital.

But in the end practical life also began to put this



question. Capital had gradually become a power. Machinery had appeared on the scene and won its great triumphs; and machinery everywhere helped to extend business on a great scale, and to give production more and more of a capitalist character. But this very introduction of machinery had begun to reveal an opposition which was forced on economic life with the development of capital, and daily grew in importance, the opposition between capital and labour.

In the old handicrafts undertaker and wage-earner, master and apprentice, belonged not so much to different social classes as simply to different generations. What the one was the other might be, and would be. If their interests for a time did diverge, yet in the long run the feeling prevailed that they belonged to one station of life. It is quite different in great capitalist industry. The undertaker who contributes the capital has seldom or never been a workman; the workman who contributes his thews and sinews will seldom or never become an undertaker. They work

at one trade like master and apprentice; but not only are they of two different ranks, they are even of different species. They belong to classes whose interests diverge as widely as their persons. Now machinery had shown how sharp could be the collision of interest between capital and labour. Those machines which bore golden fruit to the capitalist undertaker had, on their introduction, deprived thousands of workers of their bread. Even now that the first hardships are over there remains antagonism enough and to spare. It is true that capitalist and labourer share in the productiveness of capitalist undertaking, but they share in this way, that the worker usually receives little — indeed very little — while the undertaker receives much. The worker's discontent with his small share is not lessened, as it used to be in the case of the handicraft assistant, by the expectation of himself in time enjoying the lion's share; for, under large production, the worker has no such expectation. On the contrary, his discontent is aggravated by the knowledge that

to him, for his scanty wage, falls the harder work; while to the undertaker, for his ample share in the product, falls the lighter exertion—often enough no personal exertion whatever. Looking at all these contrasts of destiny and of interest, if there ever came the thought that, at bottom, it is the workers who bring into existence the products from which the undertaker draws his profit — and Adam Smith had come wonderfully near to such a thought in many passages of his widely read book — it was inevitable that some pleader for the fourth estate should begin to put the same question with regard to natural interest as had been put many centuries earlier, by the friends of the debtor, with regard to loan interest, Is interest on capital just? Is it just that the capitalist-undertaker, even if he never moves a finger, should receive, under the name of profit, a considerable share of what the workers have produced by their exertions? Should not the entire product rather fall to the workers?

The question has been before the world since the first

quarter of our century, at first put modestly, then with increasing assertiveness; and it is this fact that the interest theory has to thank for its unusual and lasting vitality. So long as the problem interested theorists alone, and was of importance only for purposes of theory, it might have slumbered on undisturbed. But it was now elevated to the rank of a great social problem which the science neither could nor would overlook. Thus the inquiries into the nature of Natural interest were as numerous and solicitous after Adam Smith's day as they had been scanty and inadequate before it.

It must be admitted that they were as averse as they were numerous. Up till Adam Smith the scientific opinion of the time had been represented by one single theory. After him opinion was divided into a number of theories conflicting with each other, and remaining so with rare persistence up till our own day. It is usually the case that new theories put themselves in the place of the old, and the old gradually yield the position. But in the

present case each new theory of interest only succeeded in placing itself by the side of the old, while the old managed to hold their place with the utmost stubbornness. In these circumstances the course of development since Adam Smith's time presents not so much the picture of a progressive reform as that of a schismatic accumulation of theories.

The work we have now before us is clearly marked out by the nature of the subject. It will consist in following the development of all the diverging systems from their origin down to the present time, and in trying to form a critical opinion on the value, or want of value, of each individual system. As the development from Adam Smith onwards simultaneously pursues different lines, I think it best to abandon the chronological order of statement which I have hitherto observed, and to group together our material according to theories.

To this end I shall try first of all to make a methodical survey of the whole mass of literature which will occupy our

attention. This will be most easily done by putting the characteristic and central question of the problem in the foreground. We shall then see at a glance how the theory differentiates itself on that central question like light on the prism.

What we have to explain is the fact that, when capital is productively employed, there regularly remains over in the hands of the undertaker a surplus proportional to the amount of this capital. This surplus owes its existence to the circumstance that the value of the goods produced by the assistance of capital is regularly greater than the value of the goods consumed in their production. The question accordingly is, Why is there this constant surplus value?

To this question Turgot had answered, There must be a surplus, because otherwise the capitalists would employ their capital in the purchase of land. Adam Smith had answered, There must be a surplus, because otherwise the capitalist would have no

interest in spending his capital productively.

Both answers we have already pronounced insufficient. What

then are the answers given by later writers?

At the outset they appear to me to follow five different

lines.

One party is content with the answers given by Turgot and

Smith, and stands by them. This line of explanation was still a

favourite one at the beginning of our century, but has been

gradually abandoned since then. I shall group these answers

together under the name of the Colourless theories.

A second party says, Capital produces the surplus. This

school, amply represented in economic literature, may be

conveniently called that of the Productivity theories. I may here

note that in their later development we shall find the

productivity theories splitting up into many varieties; into

Productivity theories in the narrower sense, that assume a direct

production of surplus on the part of capital; and into Use

theories, which explain the origin of interest in the roundabout way of making the productive use of capital a peculiar element in cost, which, like every other element of cost, demands compensation.

A third party answers, Surplus value is the equivalent of a cost which enters as a constituent into the price, viz. abstinence. For in devoting his capital to production the capitalist must give up the present enjoyment of it. This postponement of enjoyment, this “ abstinence,” is a sacrifice, and as such is a constituent element in the costs of production which demands compensation. I shall call this the Abstinence theory.

A fourth party sees in surplus value the wage for work contributed by the capitalist. For this doctrine, which also is amply represented, I shall use the name Labour theory.

Finally, a fifth party — for the most part belonging to the socialist side — answers, Surplus value does not correspond to any natural surplus whatever, but has its origin simply in the



curtailment of the just wage of the workers. I shall call this the Exploitation theory.

These are the principal lines of explanation. They are certainly numerous enough, yet they are far from exhibiting all the many forms which the interest theory has taken. We shall see rather that many of the principal lines branch off again into a multitude of essentially different types; that in many cases elements of several theories are bound up in a new and peculiar combination; and that, finally, within one and the same theoretical type, the different ways in which common fundamental thoughts are formulated, are often so strongly contrasted and so characteristic that there would be some justification in recognising individual shades of difference as separate theories.

That our prominent economic writers have exerted themselves in so many different ways for the discovery of the truth is an eloquent witness of its discovery being no less important than it is hard.

We begin with a survey of the Colourless theories.

## NOTES:

1. " In exchanging the complete manufacture either for money, for labour, or for other goods, over and above what may be sufficient to pay the price of the materials and the wages of the workmen, something must be given for the profits of the undertaker of the work, who hazards his stock in the adventure.... He could have no interest to employ them unless he expected from the sale of their work something more than what was sufficient to replace his stock to him; and he could have no interest to employ a great stock rather than a small one unless his profits were to bear some proportion to the extent of his stock" (M'Culloch's edition of 1863, p. 22). The second passage runs: " And who would have no interest to employ him unless he was to share in the produce of his labour, or unless his stock was to be replaced to him with a profit" (p. 30).

2. See also Pierstorff, *Lehre vom Unternehmerrgwin*, Berlin, 1875, p. 6; and Platter, " Der Kapitalgewinn bei Adam Smith"

(Hildebrand's Jahrbuch, vol. xxv. p. 317, etc.)

3. Book ii. chap. i. p. 123, in M'Culloch's edition.

4. When Plater in the essay above mentioned (p. 71) comes to the conclusion that, "if Smith's system be taken strictly, profit on capital appears unjustifiable," it could only be by laying all the weight on the one half of Smith's expressions, and leaving the other out of account as contradictory to his other principles.

5. Book ii. chap. iii.

6. Book i. chap. vi. The sentence was written primarily about landowners, but in the whole chapter interest on capital and rent of land are treated as parallel as against wages of labour.

^ The Invisible Hand

Adam Smith first described this principle. Since that time it has become the basis of the concept of the free market.

Self Regulating prices Consider glove manufacturers. If a glove manufacturer were to raise his prices on his gloves way above his costs, a competitor with lower prices on gloves would receive all of the orders for gloves. If all of the glove manufacturers were to raise their prices way above their costs,

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someone else would begin to manufacture gloves and sell them at a price closer to the manufacturing costs. This competi